National Energy Board

Office national de l'énergie

Reasons for Decision

Pipestone Pipelines Ltd.

OHW-1-99

February 2000

Operation of Pipeline Facilities

National Energy Board

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In the Matter of

Pipestone Pipelines Ltd.

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February 2000

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Abbreviations

Act	*National Energy Board Act*
Board	National Energy Board
Brusset	Brusset Consultants
CEAA	*Canadian Environmental Assessment Act*
Enbridge (Virden) Terminal	Enbridge Pipelines (Virden) Inc. Cromer Terminal near Cromer, Manitoba
km	kilometre
m^3/d	cubic metres per day
mm	millimetre
NEB	National Energy Board
OPR 99	NEB's *Onshore Pipeline Regulations, 1999*
Pipestone	Pipestone Pipelines Ltd.
Western & Pacific	Western & Pacific Pipelines Ltd.

Recital

IN THE MATTER OF the *National Energy Board Act* and the regulations made thereunder;

IN THE MATTER OF an application by Western & Pacific filed on behalf of Pipestone Pipelines Ltd. pursuant to section 52 of the Act for a certificate authorizing the operation of 70 km of crude oil pipeline originating at the Red Jacket Terminal near Moosomin, Saskatchewan and terminating at the point of interconnection at the Enbridge Pipelines (Virden) Inc. Cromer Terminal near Cromer, Manitoba; and

IN THE MATTER OF a written proceeding under National Energy Board Hearing Order OHW-1-99.

Chapter 1

Introduction

On 15 July 1998 Western & Pacific Pipelines Ltd. (Western & Pacific), as agent for the applicant Pipestone Pipelines Ltd. (Pipestone), filed an application pursuant to section 58 of the *National Energy Board Act* (Act) to construct a 33 km pipeline from the Red Jacket Area in Saskatchewan to the Kirkella Area in Manitoba. The proposed pipeline would form part of a new pipeline system originating at Wapella and Rocanville in Saskatchewan and terminating at the Enbridge Pipelines (Virden) Inc. Cromer Terminal near Cromer, Manitoba [Enbridge (Virden) Terminal].

In a letter dated 5 August 1998, the Board noted that the pipelines would be built as a single system and Wapella Pipelines Ltd. would operate the pipeline system as an integrated pipeline operation. Given this, the Board was of the view that the system as a whole might form a single undertaking and therefore Western & Pacific was invited to revise its application or comment on whether it believed its application to be complete.

On 13 November 1998, Western & Pacific withdrew its application from the Board as the proposed pipeline was to be constructed under provincial authority with the exception of a 100 metre portion extending across the Saskatchewan/Manitoba border. Western & Pacific applied to the Board on 17 March 1999, pursuant to subsection 19(2) and section 58 of the Act, for approval of this 100 metre connection across the provincial border.

After examining Pipestone's 17 March 1999 section 58 application, the Board determined that the application raised a constitutional question regarding the jurisdiction of the upstream and downstream facilities. The Board decided to proceed with a constitutional question regarding the jurisdiction of the upstream and downstream facilities. On 7 April 1999, the Board sent a Notice of Constitutional Question to the Attorneys-General of Canada, the provinces and the territories.

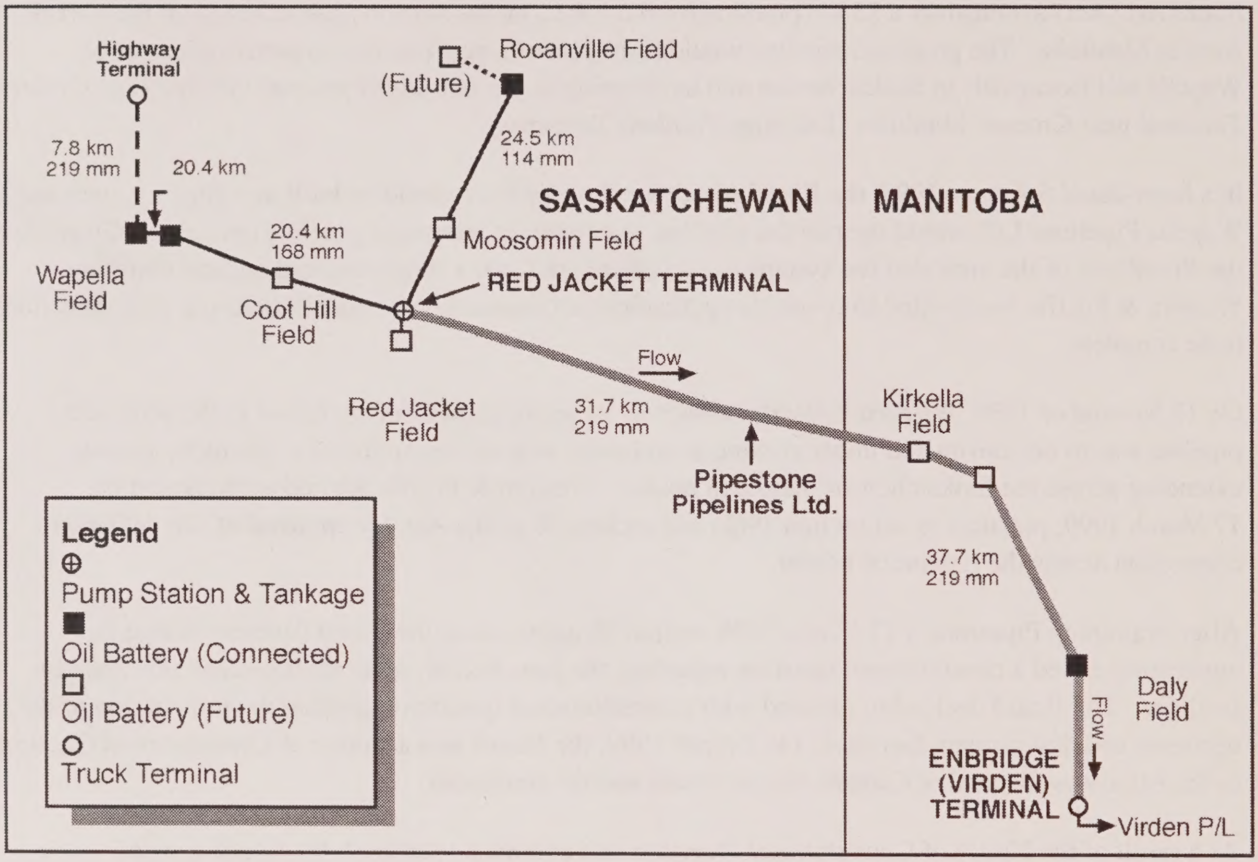
As a result of the Notice of Constitutional Question and comments received, the Board decided that a section 52 certificate would be required for the operation of the pipeline, along with a section 58 order for the construction of the 100 metres of pipeline crossing the border. In order to make a determination on the jurisdiction of the pipeline from and including Red Jacket Terminal to the interconnection at the Enbridge (Virden) Terminal, the Board requested that Pipestone submit an application for a certificate for the operation of the pipeline, pursuant to section 52 of the Act.

On 31 May 1999, Western & Pacific filed an application on behalf of Pipestone Pipelines Ltd. pursuant to section 52 of the Act for a certificate authorizing the operation of 70 km of crude oil pipeline originating at the Red Jacket Terminal near Moosomin, Saskatchewan and terminating at the point of interconnection at the Enbridge (Virden) Terminal.

With respect to the section 58 application for the construction and operation of the 100 metre section of the pipeline, on 5 July 1999 the Board issued Order XO-P176-20-99 approving the construction of this section. Leave to open was granted by the Board on 4 August 1999 under Order OPLO-P176-12-99.

The Board decided to hold a written hearing on Pipestone's section 52 application and on 7 September 1999 issued Hearing Order OHW-1-99.

Figure 1-1
Applied-for Pipestone Pipeline
Red Jacket Terminal to Enbridge (Virden) Terminal



Chapter 2

Facilities

2.1 Facilities

Pipestone has constructed a pipeline to transport crude oil from the Red Jacket Terminal located near Moosomin, Saskatchewan to the Enbridge (Virden) Terminal. Details regarding the location of the Pipestone pipeline are provided in Figure 1-1.

The estimated capital cost for the construction of the Pipestone pipeline is $10.4 million and the estimated annual operating cost is $0.4 million. The facilities included in the Pipestone pipeline project are as follows:

Red Jacket Terminal	1.	Three 318 m^3 (2000 barrels) welded steel storage tanks
	2.	Two 159 m^3 (1000 barrels) welded steel storage tanks
	3.	Three pumps
	4.	Three positive displacement meters
Mainline Pipeline	1.	70 km (43 miles) of 219 mm (8 inch) outside diameter pipe
	2.	Block valves
	3.	SCADA system with leak detection and batch tracking programs
	4.	Lease Automatic Custody Transfer Connections
Interconnection Facilities at the Enbridge (Virden) Terminal	1.	Scraper receiving trap
	2.	Back pressure valve
	3.	Densitometer
	4.	Three batch delivery valves

Views of the Board

The Board is of the view that the Pipestone pipeline, as described in the application, is an interprovincial pipeline which begins at the Red Jacket Terminal near Moosomin, Saskatchewan, and ends at the interconnection point at Enbridge (Virden) Terminal.

2.2 Safety of Construction and Operation

The Pipestone pipeline was constructed subject to the relevant provincial and federal approvals, and in accordance with the NEB's *Onshore Pipeline Regulations* SOR 89-303[1] and the Canadian Standards Association standard Z662-96, *Oil and Gas Pipeline Systems*. However, the operation and maintenance of the Pipestone pipeline will be subject to federal approval, and in accordance with the new versions of the NEB's *Onshore Pipeline Regulations, 1999* (OPR 99) and the Canadian Standards Association standard Z662-99, *Oil and Gas Pipeline Systems.*

Pipestone submitted that it will develop comprehensive, documented procedures and standards that would track, evaluate and ensure compliance with Parts III and V of the Act, the OPR 99, applicable standards, codes, specifications, programs, manuals and certificate terms and conditions.

> ***Views of the Board***
>
> The Board is satisfied that the Pipestone pipeline was designed and constructed in accordance with applicable standards, and provincial and federal regulatory requirements. As well, the Board is of the view that the facilities will be operated in accordance with the Act, OPR 99 and widely accepted industry standards.
>
> Furthermore, the Board will impose a condition on any certificate issued to Pipestone (see Appendix II) to ensure that it develops an audit program pursuant to section 53 of the OPR 99, which will evaluate and verify that Pipestone is in compliance with its procedures and standards as they relate to the protection of property and the environment and the safety of the public and of the company's employees.

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1 Amended by SOR 96-89 and SOR 98-196

Chapter 3

Environment, Socio-Economic, Consultation, and Land Matters

To fulfill its obligations pursuant to section 18 of the *Canadian Environmental Assessment Act* (CEAA), the Board conducted an environmental screening for the operation, decommissioning, and abandonment of the Pipestone pipeline, based on the application, Pipestone's responses to Board Information Requests, and public comments.

The screening was available for public comment at the conclusion of the Board's hearing process. The Directions on Procedure directed that interested parties wishing to receive a copy of the environmental screening report for comment should inform the Secretary of the Board by 8 December 1999. No requests for the screening report were received.

One intervenor in the proceeding, Mr. Kim Cousins of Elkhorn, Manitoba, raised issues related to environmental matters. Mr. Cousins stated that he had environmental and compensation concerns related to the Pipestone pipeline. The Board determined that it did not have jurisdiction to address Mr. Cousins' concerns since the portion of the pipeline on his land was built under a construction permit issued under the *Pipelines Act* of Saskatchewan. Therefore, matters arising from the construction of the pipeline are governed by the legislation of Saskatchewan. The proceeding conducted pursuant to Hearing Order OHW-1-99 addressed the operation of the pipeline only.

Pipestone also conducted a pre-construction early public notification program which included consultation with landowners, government and non-government agencies and organizations, and other interested parties. Pipestone applied for and received the necessary permits to construct the Pipestone pipeline from the relevant municipal, provincial, and federal regulatory agencies. With the exception of Mr. Cousins' concerns, no other significant environmental issues were raised during the consultation process. The Board is not aware of any other public concerns with respect to the environmental or socio-economic effects of the Pipestone pipeline project.

Pipestone did not identify any significant adverse environmental effects resulting from operation of the Pipestone pipeline. Effects resulting from the operation of the Pipestone pipeline are primarily limited to potential impacts relating to management of wastes, accidents and malfunctions, and other typical issues related to the ongoing operation of the pipeline. These issues will be addressed through Pipestone's manuals and operating procedures, which formed a part of its application, and have been or will be, developed in accordance with the OPR 99.

Views of the Board

The Board is of the view that if Pipestone's proposed environmental mitigative measures are implemented, including those agreed to by Pipestone with other regulatory agencies as well as those imposed by the Board in any certificate issued to Pipestone, the project is not likely to cause significant adverse environmental effects.

The Board is satisfied that the public, government agencies, public interest groups, Aboriginal groups, landowners, and potentially affected parties have been made aware of the operation of the Pipestone pipeline and have had the opportunity to comment and have their comments taken into consideration.

To document any reclamation or other environmental issues that should be resolved, the Board will impose a post-construction environmental reporting condition on any certificate issued to Pipestone (see Appendix II) .

Chapter 4

Supply, Markets and Economic Matters

4.1 Supply

Pipestone provided a production forecast that was prepared for the company by Brusset Consultants (Brusset) in May 1998 and updated in October 1998. The updated forecast estimated that crude oil production in the area served by the pipeline from proved plus probable additional reserves would average 1483 m^3/d in 1999, and decline to 626 m^3/d by the year 2004. The Brusset update noted that its forecast included production from developments that were in place or had been planned prior to 31 July 1998. Therefore, production from any development instituted after this date was not included in the forecast.

Pipestone submitted that, in addition to considering the Brusset forecast, the company consulted with area producers to assess their plans to maintain or increase present production. Based on this information, Pipestone concluded that a reasonable forecast of 1999 production in the area served by the pipeline is 1750 m^3/d. Pipestone further indicated that there is a prospect of attracting additional volumes to the pipeline from outside the Pipestone service area. Given the producer drilling and development plans and the prospect of additional volumes from outside the service area, Pipestone forecasted a three percent annual decline in crude oil production available to the pipeline over the next ten years.

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Production (m^3/d)	1750	1698	1647	1597	1549	1503	1458	1414	1372	1330	1290	1252

Views of the Board

The Board accepts as reasonable Pipestone's forecast of 1750 m^3/d for 1999 production in the area served by the pipeline. The Board also accepts as reasonable the forecast of an annual three percent decline in volumes that may be available to the pipeline over the next ten years.

4.2 Markets

Although direct evidence regarding markets was not provided in the application, Pipestone indicated that all of the crude oil that would be initially transported by the pipeline was currently being transported by truck to the Enbridge (Virden) Terminal. Pipestone also provided a list of shippers that have agreed to use the pipeline.

Views of the Board

Based on the fact that the oil currently being produced in the service area is being marketed and evidence that shippers intend to use the pipeline, the Board considers that sufficient markets and access to markets exist to accommodate the crude oil that would be transported by the pipeline.

4.3 Throughput

The 1999 to 2004 throughput forecast provided by Pipestone indicated that the average annual volume that would be transported by the pipeline would be equivalent to the total crude oil production in the area served by the pipeline.

Pipestone submitted that its forecast for 1999 throughput was related to its estimate of production from fields within the Pipestone service area. However, Pipestone considered that additional volumes would be attracted to the pipeline from outside the service area. The Brusset report identified one area, the Hazelwood Field, that could provide a source of production outside the service area. The report stated that this field, which was expected to produce approximately 442 m^3/d of crude oil in 1999, is declining rapidly and has little further development potential.

Pipestone indicated that, at the time of its application, 83 percent of the total crude oil production in the area had been committed to the pipeline (1452 m^3/d out of a total possible 1750 m^3/d in 1999). Supporting evidence indicated that, of the committed volume:

1. 1100 m^3/d, (63 percent of the total expected 1999 throughput) had been committed from four initially connected batteries,
2. 152 m^3/d (nine percent of the total expected 1999 throughput) would come from trucked volumes produced in the service area, and
3. 200 m^3/d (11 percent of the total expected 1999 throughput) will be sourced from fields outside the Pipestone service area.

No source was provided for the volume committed from outside the service area.

Views of the Board

The Board is satisfied that sufficient throughput will be available to support the initial operation of the pipeline. However, as production in the service area and in the only potential source area identified outside the service area is declining, the Board will attach a condition to any certificate issued to Pipestone requiring it to report its throughput to the Board on an annual basis (see Appendix II).

4.4 Economic Feasibility

The Pipestone pipeline was built in 1999 for an estimated cost of $10.4 million and has an estimated annual operating cost of $0.4 million. The project was financed through a combination of bank financing, shareholder equity and loans, a bank operating facility, and a letter of credit arranged through a major bank.

Pipestone submitted that the project was undertaken on an "at-risk" basis and any future financial risk associated with underutilised capacity will be borne by the pipeline and its shareholders. The pipeline's owners are Austpro Energy Corp. (25%), Tundra Oil and Gas Ltd. (37.5%) and TransX Ltd. (37.5%).

In its application, Pipestone stated that all the crude oil proposed to be transported by the pipeline is currently being transported by truck to the Enbridge (Virden) Inc. truck-unloading terminal near Cromer, Manitoba. Pipestone argued that the cost of transporting oil via the proposed pipeline is approximately \$.75 per m^3 less than by truck. This represents an annual saving to oil shippers of about \$0.4 million. As well, a number of shippers have signed transportation agreements with Pipestone.

Letters of support for the project were submitted by CANPET Energy Group Inc. and the Saskatchewan Minister of Energy and Mines.

Views of the Board

Due to the fact that the pipeline has already been built, the Board is now primarily concerned with Pipestone's ability to finance its ongoing operational requirements. The Board observes that Pipestone was able to attract sufficient financing from its shareholders and a major Canadian bank to construct and commence operation of the pipeline under provincial jurisdiction. In the Board's view, this financial support demonstrates a commitment by Pipestone's shareholders and bank to ensure that the pipeline remains viable and can provide a sufficient return on investment.

The Board also notes that producers have signed transportation agreements with Pipestone, thereby demonstrating their willingness to ship oil at the rates proposed by the pipeline. Assuming Pipestone continues to offer competitive rates, the Board is of the view that the pipeline should remain viable into the future. In addition, the Board notes that it is the pipeline, and not its shippers, which will assume the financial risk associated with underutilized capacity. Based on the above, the Board is satisfied with Pipestone's ability to finance its ongoing operational requirements.

By transporting oil on the Pipestone pipeline, the Board is of the view that shippers are likely to realize cost savings as compared to transporting by truck. The Board is also of the view that the evidence indicates that the Pipestone pipeline is likely to be used and useful for a reasonable period of time.

Chapter 5

Tolls, Tariff and Form of Regulation

5.1 Tolls

Pipestone has applied to set its tolls on a market basis rather than using a traditional cost-of-service approach. In developing its proposed tolls, Pipestone calculated the current cost of trucking oil from the field (including both gathering and trunk lines) to the Enbridge (Virden) Inc. truck-unloading terminal near Cromer, Manitoba, then discounted this amount by an average of \$.75/m^3. The resulting tolls for the trunk line are presented below.

Pipeline Receipt Points to Cromer	\$/m^3@15 degrees Celsius
Daly Field (LSD 01-29-10-28 W1M)	0.82
Red Jacket Terminal (LSD 06-04-14-32 W1M)	3.5

Pipestone believes that these tolls are sufficiently competitive to entice shippers to abandon trucking service in favour of using the pipeline, while still ensuring adequate revenues to both operate the pipeline and provide an acceptable rate of return.

The applicant also submitted that the concepts of rate base and cost-of-service recovery are not relevant in the determination of its tolls, and requested relief from the requirement to file toll information in the format outlined in section 17 of Part IV of the Board's *Guidelines for Filing Requirements.*

Views of the Board

Section 62 of the Act provides that "all tolls shall be just and reasonable, and shall always, under substantially similar circumstances and conditions with respect to all traffic of the same description carried over the same route, be charged equally to all persons at the same rate." Furthermore, section 67 of the Act dictates that "a company shall not make any unjust discrimination in tolls, service or facilities against any person or locality."

In the Board's view, support for the proposed tolls is evidenced by the level of volumes contracted by producers for transportation on the pipeline. Further, no objections were received during the hearing process from interested parties with respect to the proposed tolls or toll design. The Board notes that, should issues arise in the future with respect to tolling matters, shippers have the right to terminate their contracts after one year and return to trucking their oil to the Enbridge pipeline. Further, shippers always have the right to file a complaint with the Board if they are unable to resolve any toll, traffic and tariff issues with the company. Finally, the Board retains the right to examine tolls on its own initiative.

Based on the above and the evidence filed by the applicant, the Board is satisfied that the proposed tolls are just and reasonable and will not result in unjust discrimination.

The Board notes that the accounting treatment of the cost of the pipeline construction must conform with generally accepted accounting principles pursuant to subsection 5(2) of the *Oil Pipeline Uniform Accounting Regulations*. In addition, the cost of this project, including any cost overruns, may be subject to examination pursuant to the Board's responsibilities under Part IV of the Act.

Finally, the Board has determined that rate base and cost-of-service information is irrelevant for Pipestone's market-based tolls, and has decided to grant the pipeline relief from filing the information outlined in section 17 of Part IV of the Board's *Guidelines for Filing Requirements*.

5.2 Tariff

Pipestone advised that producers have signed pipeline transportation agreements committing 83% of the pipeline's 1750 m^3/day of initial volumes. Pipestone has provided the Board with a *pro forma* copy of its "Pipeline Transportation Agreement" (the agreement) and copies of some of the executed agreements. Any additional parties wishing to contract volumes on the pipeline will be required to sign the agreement.

By signing the agreement, a shipper is subject to the provisions of the pipeline's "Tariff" and "Schedule of Tariff Rates", copies of which were sent to all the shippers in the area and were filed with the Board. The agreement binds parties for a period of one-year and may be terminated at any point thereafter, by either the pipeline or the producer, subject to 90-days written notice.

Views of the Board

The Board has examined Pipestone's transportation agreement and tariff, and is satisfied that capacity on the pipeline will be available on an open access basis to all potential shippers.

5.3 Form of Regulation

The Board is required to determine how Pipestone should be regulated for the purposes of tolls and tariffs (i.e., as a Group 1 or Group 2 company). Pursuant to the Board's *Memorandum of Guidance on the Regulation of Group 2 Companies* issued on 6 December 1995, Group 2 companies are subject to a lesser degree of regulation than Group 1 companies. The financial regulation of Group 2 companies is carried out on a complaint basis, with a consequential reduction in financial reporting requirements.

Views of the Board

The Board notes that Pipestone did not apply for Group 2 status; however, the pipeline has included wording in its draft tariff which suggests that it expects to be regulated as a Group 2 company.

Due to the market-based nature of Pipestone's tolls, the cost-of-service-type information typically reported for Group 1 companies would not be available nor relevant for the pipeline. Further, the small number of shippers on the pipeline, and the simplicity of both its toll design and its service offerings, does not warrant unnecessary administrative and economic burden on the company. Accordingly, the Board is of the view that Pipestone should be designated as a Group 2 company for the purposes of financial regulation.

Subsection 60(1) of the Act provides that "A company shall not charge any tolls except tolls that are (a) specified in a tariff that has been filed with the Board and is in effect; or (b) approved by an order of the Board." Pursuant to paragraph 60(1)(a) of the Act, Pipestone will be required to file its final tolls and tariffs with the Board prior to commencement of operation under any certificate issued by the Board. As is the Board's normal practice for Group 2 companies, it will not be necessary for the Board to issue an order approving Pipestone's proposed tolls and tariffs under paragraph 60(1)(b) of the Act.

As a Group 2 company, Pipestone is required to include in its tariff the explanatory note set out in Schedule B of the *Memorandum of Guidance on the Regulation of Group 2 Companies*. The explanatory note indicates that persons who cannot resolve traffic, toll and tariff issues with a pipeline company may file a complaint with the Board.

Chapter 6

Disposition

The foregoing constitutes our Reasons for Decision in respect of the application heard by the Board in the OHW-1-99 proceeding. The Board is satisfied that the Pipestone pipeline will be required by the present and future public convenience and necessity.

The Board approves Pipestone's application made pursuant to section 52 of the Act for the operation of a 70 km long, 219.1 mm crude oil pipeline from Red Jacket terminal in Saskatchewan to the Enbridge (Virden) Terminal. The Board will recommend to the Governor in Council that a certificate be issued, subject to the conditions set out in Appendix II.

The Board grants Pipestone's requested relief from filing rate base and cost-of-service information, as outlined in the *Guidelines for Filing Requirements*, due to the fact that Pipestone's tolls will be market-based.

K.W. Vollman
Chairman

R.J. Harrison
Member

J.S. Bulger
Member

J.-P. Théorêt
Member

E. Quarshie
Member

D. Emes
Member

C. Dybwad
Member

February 2000
Calgary, Alberta

Appendix I

List of Issues

1. The safety of the operation of the applied-for facilities.

2. The potential environmental and socio-economic effects of the operation of the applied-for facilities.

3. The financial viability of the applied-for facilities.

4. The economic feasibility of the applied-for facilities.

5. The appropriate terms and conditions to be included in any approval which may be granted.

Appendix II

Certificate Conditions

1. Unless the Board otherwise directs, Pipestone shall develop an audit program for the protection of property, the environment, and the safety of the public and the company's employees pursuant to section 53 of the OPR 99 and file with the Board, within 60 days of the issuance of the certificate, a schedule for the development of the procedures and standards as well as when Pipestone expects to complete the planning, design and development of the audit program or phases of the program.

2. Unless the Board otherwise directs, Pipestone shall file with the Board on or before 31 July 2000 and 31 December 2001 a report addressing environmental issues which have been identified along the Pipestone pipeline right of way. The environmental report shall include:

    a) a description of the condition of the right of way including the success of clean-up and reclamation;
    b) an assessment of environmental issues which remain unresolved, including those related to clean-up and reclamation, and the measures Pipestone proposes to take in respect of the unresolved issues; and
    c) any other environmental issues which Pipestone feels are relevant to the Pipestone pipeline.

    The 1999 and spring 2000 growing seasons shall be included in the 31 July 2000 report and the 1999 to 2001 growing seasons shall be included in the 31 December 2001 report.

3. Unless the Board otherwise directs, Pipestone shall file with the Board annually, on or before 31 January, its throughput for the previous year.

4. Unless the Board otherwise directs, Pipestone is required to file its final tolls and tariffs with the Board prior to commencement of operation under the Board's certificate.

Canada